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A Study on Convergence of International Accounting Standards

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***Abstract*: International Financial Reporting standards are a set of accounting standards developed by international accounting standard board that is becoming global standard for the preparation of public company financial statements. Consistently, comparable understandable financial information is the lifeblood of commerce and making investment. Increasing cross boarder investing and proliferation of financial products have passed challenges to companies as they faced multiple standards. This paper deals with three major aspects of convergence of international accounting standards. The first one is to identify that how it aids the companies in business development and also for their growth strategies. The second one is to know about the increased comparability of the financial statements. And the last one is to indicate the impact of IFRS on financial decisions. This paper will also throw light challenges can happen in the company's financial statements after the adoption of IFRS. In simple words, the authors aim to comment on the adoption of IFRS in India by the firms in order to know the importance of financial statements and to analyse the changes of financial statement after the adoption of IFRS by using different financial ratios. The data are from annual report of Wipro limited from 2009 to 2013.1**

***Keywords*: Convergence, financial ratios, accounting standards, investment.**

1. Introduction

Generally accepted accounting principles (GAAP) are a common set of accounting principles, standards and procedures that companies must follow when they compile their financial statements. GAAP is a combination of authoritative standards (set by policy boards) and the commonly accepted ways of recording and reporting accounting information. GAAP improves the clarity of the communication of financial information. The wave of globalization has brought drastic changes in business environment across the world. Apart from doing in one nation, the emerging business corporation are raising finance from international capital and money market. Due to the inherent limitation in GAAP and the widespread investment in international companies that cross national boundaries many accounting and financial professionals are advocating for the worldwide adoption of the international reporting standards of IFRS used in over 100 countries.

IFRS is a single set of international accounting standards to assist companies to communicate and stakeholders to compare corporate financial information across the world. A company financial statement provides various financial information that investors and creditors use to evaluate a company's financial performance. After the adoption of IFRS investors who want to invest in other companies or want to change the business line will be benefited as there is transparency in financial statements. Convergence with IFRS implies to achieve harmony with IFRS and to design and maintain national accounting standards in a way that they comply with international accounting standards. The universally accepted language of IFRS will help the investors across the globe people from various nation start making investment from one country to other nation and it will leads the flow of international capital from one nation to another that is going to help the world across the globe. It will facilitate not only the international trade but sometime movement of international capital [2].

2. Literature review

SRIVASTAVA (2009) emphasized on "convergence of IAS with IFRS: prospects and challenges". He opined that by adopting the IFRS, it gives a greater benefit to the investors, professionals and the economy as a whole. Therefore, Indian companies have begun to align their accounting standards to the international financial reporting standards, finally this can be resulted in international initiative of convergence of accounting standards to a common

standard and it certainly helps the investors to invest across the globe and people from various nations start investment from one country to another nation [3].

Suresh (2015) study on convergence Indian accounting standard to IFRS – "A journey towards global standards". Findings of the study is to know whether IFRS are helpful to companies in preparing the financial statements. And what all are the difficulties involved in implementing the IFRS in India. Finally, this study results to remove the variations in profits, IAS company irrespective of their locations should follow IFRS in preparing financial statements are commonly accounting standards followed by all member countries.

The study of P.A. Isenmila (2013) reveals IFRS introduction will facilitate better investment decision making in the capital market. The new standards will lead to enhanced or favourable financial measure, such as profitability, growth, leverage, liquidity, and size, good corporate practices, quality and timelines of management information and transparency.4

The study of Dr. B. Shekar (2013) shows that IFRS removes the confusion from the minds of the investors because it gives accurate, transparent single accounting statements. And also, it will be helpful for investors to take a proper decision [5].

Lantto and Sahlstron (2009) the study examine impact of IFRS adoption on key financial ratios using Finland as sample the result clearly shows the adoption of IFRS changes the magnitude of key accounting ratios [6].

3. Research GAAP

Many studies have been conducted on Convergence of IAS with IFRS, preparation of financial statements, investment decision and financial ratios. From the above literature review it is evident that a few researches have been conducted on adoption of IFRS and its influences for company's financial statement. Hence the present study has been undertaken to study the impact of IFRS on financial ratios of a company.

A. Research methodology

The present paper is an attempt to analyses the impact of the adoption of international financial standards on financial decisions. It compares the financial parameters under Indian GAAP and IFRS as reported by Wipro Limited for a period starting from 2009-2010 to 2012-2013.and stakeholders both internally and externally. The study analyses financial statements of Wipro Limited, annual reports from 2009 to 2013.the financial ratios under GAAP and

IFRS are also focused for the analysis. By comparing the financial ratios between GAAP and IFRS, the study provides required information which will help the financial decision makers such as investors, creditors and other analysts. 7 financial ratios are taken here and are categorized in to 4 main categories, such as liquidity ratio, debt, equity and profitability.

4. Statement of problem

As GAAP was the first accounting standard used in Indian company, but there was difficulty regarding comparison of financial statements of two companies in different countries which effected the global investors. To overcome this issue IFRS is implemented. This Research concentrates in analysing the changes of financial statement i.e. GAAP and IFRS by using different financial ratios which will benefit the industry and also the investors in decision making and so on.

A. Scope of the study

The study was undertaken to assess the changes occurred after the adoption of IFRS, with the financial statement of the companies and how it will affect the investor's decision towards global investment in the capital market. Annual report of the Wipro ltd has been selected to analyse various financial ratios under both IFRS and Indian GAAP for this purpose.

B. Objective of the study

- To understand/ identify how IFRS aids the companies in business development
- To indicate the impact of IFRS on financial decision.
- To analyze the changes in financial statement after the adoption of IFRS

C. Limitation of the study

The study on "CONVERGENCE OF ACCOUNTING STANDARDS WITH IFRS" has few limitations as follows:

- The study is exclusive based on secondary data.
- The study has been restricted by taking 1 IT company for analysis.
- The study does not consider all the financial ratios.

5. Data analysis and interpretation

A. Liquidity ratio

It is a measure of company's ability to meet short term financial obligations. From Table 1 it is clear that both current ratio and quick ratio have been increased significantly. The change is from negative15% to positive 17% for the period 2010-2013.it shows the good liquidity position of the company which not only helps to deal with the financial obligation but also to declare dividend, expansion and diversification. If the liabilities decreasing it is good news for shareholder as it is increasing the value of assets.

We can find a significant improvement in the liquidity ratio due to the reduced current liabilities and strengthened current assets. Under Indian GAAP the dividend is provided to the shareholders before the approval but in case of IFRS the dividend is provided only after the approval by shareholders. Under IFRS the assets are measured on fair value at the reporting date. Whereas under Indian GAAP assets are measured at cost or market value whichever is lower. This difference has created a better liquidity position.

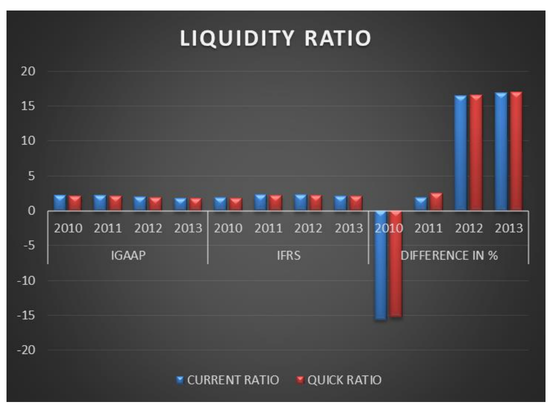

Fig. 1. Liquidity ratio

Interpretation:

It is a measure which is used to indicate relation between portion of asset provided by stock holders and portion of asset financed by creditors. The company will be at risk when there is a high debt equity ratio.

Table 2 shows that the ratio has decreased from negative 13.34% to 14.74% between 2010 and 2013 respectively. Low debt indicates low risk and it provides confidence to the lenders that their debt will be repaid on time. An average debt equity ratio for 4 years around 0.57 under IFRS as against 0.66 under Indian GAAP reflects financial efficiency of the company.

Decreased liability is on account of reporting difference under IFRS in accounting of provision for dividend and application of fair value principle.

B. Interest coverage ratio

It is a measure to indicate company's ability to pay interest on the debt. Table two shows difference in interest coverage ratio between Indian GAAP and IFRS from a negative 6.28% in 2010 to positive 7.08% in 2013. Interest coverage under IFRS in the year 2010 and 2011 were very low, this is because of the exchange fluctuations of foreign currency borrowings which is shown as interest expenses in IFRS ability to pay interest on borrowings is a measure to test solvency of the company, which ensures a positive signal to the lender on margin of safety.

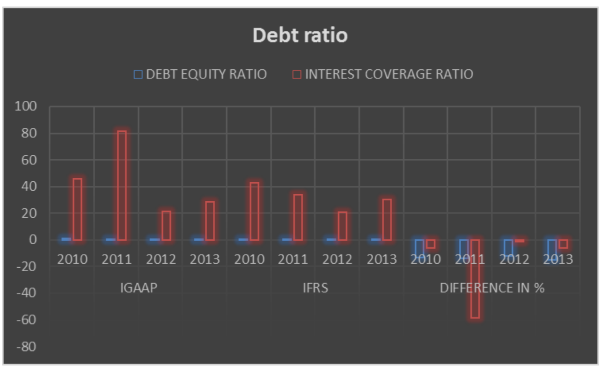

Fig. 2. Debt ratio

C. Proprietary ratio

It is a relationship between owner's fund and total assets. It reflects how the owner's funds are invested in different types of asset. High ratio indicates long term solvency position. As per table three the difference of proprietary ratio between all the four years is 6%. High proprietary ratio under IFRS indicates soundness of capital structures.

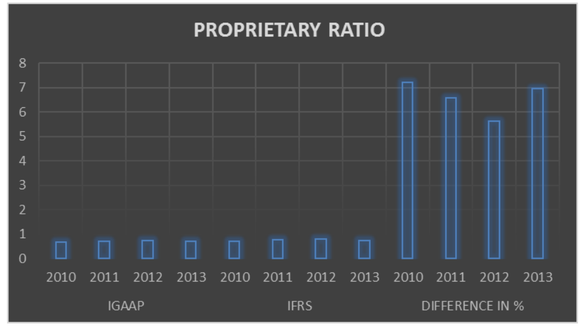

Fig. 3. Proprietary ratio

D. Net profit ratio

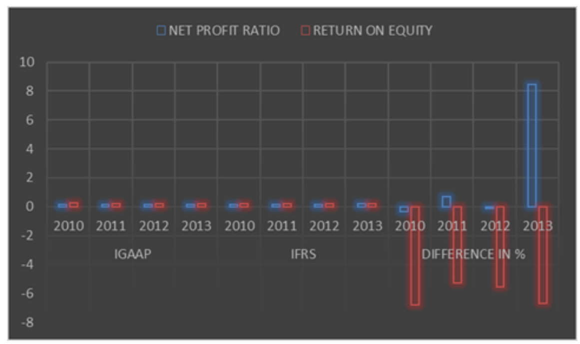

Fig. 4. Net profit ratio (Source: Excel output & annual report)

It is a measure of the efficiency of the company. Low profit indicates low margin of safety.Net profit % difference of the

Table 1
Liquidity ratio, Wipro Ltd.

RATIOS	**IGAAP**				IFRS				DIFFERENCE IN %			
	2010	**2011**	**2012**	**2013**	**2010**	**2011**	**2012**	**2013**	**2010**	**2011**	**2012**	**2013**
Current ratio	2.26	2.27	1.99	1.82	1.9	2.31	2.32	2.12	15.61	1.86	16.52	16.96
Quick ratio	2.16	2.16	1.92	1.8	1.83	2.21	2.23	2.1	15.24	2.49	16.6	16.98

Table 2
Debt Equity Ratio -Wipro Limited

RATIO	**IGAAP**				**IFRS**				**DIFFERENCE IN %**			
	2010	**2011**	**2012**	**2013**	**2010**	**2011**	**2012**	**2013**	**2010**	**2011**	**2012**	**2013**
Debt equity ratio	0.78	0.63	0.6	0.64	0.68	0.55	0.52	0.54	-13.34	-13.76	-12.16	-14.74
Interest coverage ratio	45.72	81.35	21.3	28.19	42.85	33.61	20.98	30.19	-6.28	-58.68	-1.51	-6.28

Source: Annual Report

Table 3
Equity Ratio Wipro Limited

RATIO	**IGAAP**				**IFRS**				**DIFFERENCE IN %**			
	2010	2011	2012	2013	2010	2011	2012	2013	2010	2011	2012	2013
Proprietary ratio	0.67	0.72	0.74	0.7	0.72	0.77	0.79	0.74	7.21	6.58	5.63	6.97

Table 4
Profitability Ratio Wipro Limited

RATIO	**IGAAP**				**IFRS**				**DIFFERENCE IN %**			
	2010	2011	2012	2013	2010	2011	2012	2013	2010	2011	2012	2013
Net profit ratio	0.17	0.17	0.15	0.16	0.17	0.17	0.15	0.18	0.36	0.7	-0.13	8.46
Return on equity	0.25	0.23	0.21	0.23	0.23	0.22	0.2	0.22	-6.8	-5.26	-5.56	-6.69

year 2013 under Indian GAAP and IFRS is 8.46. And all other year's amount remains same. This is due to demerger of operations by certain companies, by which assets and liabilities are adjusted against reserves of Wipro limited, high and consistent profitability of the company is looked into by investors to understand the risk of investing.

Table 4, also show minor difference in ratios under IFRS and Indian GAAP for return on equity. It is a measure of financial efficiency of a company. IFRS facilitates stake holder's investors and lenders to identify their share on return of company.

E. Overall view of the above analysis

This study helps us to understand about the impact of IFRS adoption on accounting figures and key financial ratios of Wipro ltd used by investors, creditors, and analyst etc. the result indicates significant changes in the liquidity ratios, equity ratios, and interest coverage ratio and marginal increase in debt equity ratio and no significant change in the case of profitability ratio.

As the users of financial statement won't be understandable by many of the people the notes provided under the financial statements in the IFRS will help the reader to understand and analyse about the financial performance of the company.by doing so the IFRS helps the company for the purpose of internal control also.

Overall results states that the fair value recording of report and strict requirement in adhering to accounting standards have strengthened the financial figures and provided decision makers a transparent, true, and fair accounting picture.

6. Findings

- Following are some observation from secondary data analysis: As a part of secondary data analysis, we have collected data of debt equity ratio, liquidity, profitability and proprietary ratio of Wipro ltd for the year 2009-2013.
- By net profit ratio, we can find the difference of ratios of the year 2013 under Indian GAAP and IFRS is 8.42, which states high profitability of the company which is looked into by the investors.
- By calculating Liquidity ratios, it is cleared that the ratios have been increased from a negative 15% to positive 17% for the period 2010-2013, it shows the liquidity position is good for the expansion and diversification of the company.
- By the Debt equity ratio, we can find an increase of percentage in ratios from negative13.34% to 14.74% between 2010-2013 it indicates the low risk that provides confidence for the lenders.
- By calculating Equity ratio, it is clear that proprietary ratio between all the four year is 6%, this high ratio under IFRS indicates soundness of capital structure.

7. Suggestions

On the basis of analysis of secondary data, our suggestions regarding the process of IFRS. Make effective plan for convergence successful

- Preliminary impact assessment
- Planning and designing
- Testing on trial and error basis and problem solution.
- Implementation
- Post-implementation analysis
- Sufficient time and strategy should be adopted for an impact assessment of IFRS business in initial stage.
- Consultancy from external advisor for successful implementation of impact assessment.
- Implementation of IFRS for business as soon as possible will help in managing the better expectation of internal stakeholders such as board of directors, senior managers and investors and analyst about equity.

8. Conclusion

Adoption of IFRS in India as significantly changed the content of corporate financial statement, to generate transparency with a rapid liberalization process experienced in India over the past decade. There is huge presence of multinational enterprises in the country, further more Indian companies are also investing in foreign market. The adoption of IFRS will be showing a better financial position of the company as per the interpretation given above. It is clear that the financial ratios show a better position under IFRS. The major reason for the difference in ratio could be attributed to the principle based IFRS standards which requires a fair value accounting and balance sheet approach to deferred tax and timing of providing provision for proposed dividend. Hence IFRS provides transparent, comparable accounting standards.

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